IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 07.06.2007

CORAM

THE HON'BLE MR.JUSTICE P.D.DINAKARAN
AND
THE HON'BLE MR.JUSTICE P.P.S.JANARTHANA RAJA

T.C.(A) No.458 of 2007

Commissioner of Income Tax
Chennai. .. Appellant/Respondent

Vs.

Sabena Detergents Private Ltd.,
(Now Known as Ecof Detergents
Pvt. Ltd.) 310, T.T.K.Road,
Chennai. .. Respondent/Appellant

Appeal under Section 260A of the Income Tax Act, 1961 against the order of the Income Tax Appellate Tribunal, Madras 'C' Bench dated 23.11.2006 in ITA No.1750/Mds/1999 for the assessment year 1996-97, against the Order of the Commissioner of Income Tax (A) IV Chennai dated 15.10.99 and made in ITA.No.251/99-2000/Com.Iv (4) against the Order of the Deputy Commissioner of Income Tax, Company Circle IV (4) Chennai-6 dated 31.3.99 and made in PAN/GIR No.2273-S.

For Appellant : Mr.J.Naresh Kumar, Jr.S.C.

J U D G M E N T

(Delivered by P.D.DINAKARAN,J.)

The above tax case appeal is preferred by the Revenue against the order of the Income-tax Appellate Tribunal dated 23.11.2006 made in I.T.A.No.1750/Mds/1999 for the assessment year 1996-97, raising the substantial question of law, viz.,

> " Whether the Tribunal was right in holding that the advertisement expenditure incurred for promoting the pickles manufactured by its sister concern, for which the assessee is the distributor and selling agent, is allowable as the assessee's business expenditure ?"

under the following facts and circumstances of the case.

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2.1. The assessment year involved in this appeal is 1996-97. The assessee is a private limited company engaged in the business of trading in scouring powder, pickles, etc. During the relevant assessment year, the assessee claimed expenditure for advertisement of pickles marketed by it, which are manufactured by its sister concerns. But, the Assessing Officer noting that the advertisement expenditure includes a sum of Rs.25,69,405/- towards expenditure incurred for promoting the products manufactured by its sister concerns and observing that there is no memorandum of understanding or agreement between the assessee company and the manufacturing company in this regard, by assessment order dated 31.3.99, held that the advertisement expenditure incurred by the assessee on behalf of its sister concerns cannot be allowed as expenses attributable to its business. Accordingly, the said sum of Rs.25,69,405/- claimed by the assessee towards advertisement expenditure was disallowed and added back to the total income of the assessee.

2.2. Against the said assessment order of the Assessing Officer, the assessee preferred an appeal before the Commissioner of Income-tax (Appeals). The Commissioner has found that the assessee had been acting as an agent for marketing the products manufactured by its sister concerns, viz., Telkar Brand Tickles and M/s.Telkar Food Products Private Limited, and that as per the letter dated 31.3.95 of the principal manufacturer, viz., M/s.Telkar Food Products Private Limited, the assessee has to bear the cost of exhibition, display and screening of advertisements, in order to promote and boost the sale of pickles manufactured by the sister concerns. Even though the principal manufacturer would provide basic advertisement matters, the assessee had incurred expenditure to the tune of Rs.25,69,405/- towards display and screening of advertisements during exhibition. However, the Commissioner has found that though the assessee contended that by virtue of the letter of the pricipal manufacturer, it was required to bear the cost of exhibition, display and screening of advertisements, the said letter dated 31.3.95 is only a self-serving evidence and in the absence of any validly executed agreement or understanding between the assessee and its sister concerns, the expenditure incurred towards display and screening of advertisements during exhibition cannot be allowed and thus, dismissed the appeal by his order dated 15.10.1999.

2.3. On further appeal by the assessee, the Income-tax Appellate Tribunal, while appreciating the contentions made on behalf of the assessee that the assessee company is engaged in the business of trading in scouring powder, pickles, etc. manufactured by its sister concerns and operating its business in Andhra Pradesh, Karnataka, Kerala and Tamil Nadu, held that the advertisement expenditure incurred by the assessee cannot be strictly construed as expenditure incurred for promoting the products manufactured by its sister concerns, but also for the purpose of assessee's trade, as the assessee itself is a marketing agent to the pickles as well as Sabena Scouring powder manufactured by its sister concerns and is a sole distributor of the said products and thus, allowed the expenditure in favour of the assessee. Hence, the present appeal by the Revenue raising the substantial question of law already referred to above.

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3. Before deciding the substantial question of law raised in this appeal, it is apt to refer Section 37(1) of the Income-tax Act, 1961 (hereinafter referred to as 'the Act'), which permits the assessee to claim any expenditure by way of deduction in computing the income chargeable under the head "Profits and gains of business or profession", which reads as follows:-

> "37. (1) Any expenditure (not being expenditure of the nature described in sections 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee, laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession".
>
> Explanation – For the removal of doubts, it is hereby declared that any expenditure incurred by an assessee for any purpose which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession and no deduction or allowance shall be made in respect of such expenditure."

4. A careful reading of Section 37(1) of the Act makes it clear that for allowing any expenditure while computing the income chargeable under the head "Profits and gains of business or profession", such expenditure must be (a) paid out wholly and exclusively for the purpose of business or profession and (b) must not be (i) capital expenditure, (ii) personal expenses and (iii) an allowance of the character described in Section 30 to 36 of the Act.

5.1. A Full Bench of the Apex Court in COMMISSIONER OF INCOME-TAX v. MALAYALAM PLANTATIONS LTD. [1964] 53 I.T.R. 140, while interpreting the expression "for the purpose of the business" used in Section 10(2)(xv) of the Income-tax Act, 1922 (hereinafter referred to as 'the old Act'), held as hereunder:-

> "The expression "for the purpose of the business" is wider in scope than the expression "for the purpose of earning profits". Its range is wide; it may take in not only the day to day running of a business but also the rationalisation of its administration and modernisation of its machinery; it may include measures for the preservation of the business and for the protection of its assets and property from expropriation, coercive process or assertion of hostile title; it may also comprehend payment of statutory dues and taxes imposed as a pre-condition to commence or for the carrying on of a business; it may comprehend many other acts incidental to the carrying on of the business. However wide the meaning of the expression may be, its limits are implicit in it. The purpose shall be for the purpose of the business, that is to say, the expenditure incurred shall be for the carrying on of the business and the assessee shall incur it in his capacity as a person carrying on the business. It cannot include sums spent by the assessee as agent of a third party, whether the origin of the agency is

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voluntary or statutory."

5.2. In the instant case, it is the clear case of the assessee that it is not only acting as an agent to the products manufactured by its sister concerns, but also engaged in the business of trading in scouring powder, pickles, etc. In other words, the marketing of the products manufactured by M/s.Telkar Food Products Private Limited, by itself, is a trade undertaken by the assessee and the expenses in question claimed by the assessee are the expenses incurred during the course of such marketing.

5.3. In the above said decision, Justice.Subba Rao, as he then was, speaking for the Full Bench of the Apex Court, placed reliance on the decision of the House of Lords in Southern v. Borax Consolidated Ltd. [1942] 10 I.T.R. 1, whereunder it was held that the amount spent wholly and exclusively for the purpose of the company's trade was a allowable deduction for the purpose of computing the profits of the company for income-tax purposes and accordingly, the expression "for the purpose of business" is to be given a liberal meaning, as it includes the purpose to promote the business of trade.

5.4. The decision of the House of Lords in Morgan v. Tate and Lyle Ltd. [1954] 26 I.T.R. 195, was also relied upon by the Apex Court, whereunder the question that arose was whether the expenditure incurred by a company engaged in sugar refining, in a propaganda campaign to oppose the threatened nationalisation of the industry, was an admissible deduction. In the said case, it was held that Lord Davey's formula includes expenditure for the purpose of preventing a person from being disabled from carrying on and earning profits in the trade. The resultant tests would be (i) whether the was expenditure incurred for the purpose of carrying on the business to earn profits in the trade and for removing obstacles and impediments in the conduct of the business; and (ii) whether the assessee paid the amount in his capacity as businessman or in his personal capacity.

5.5. In the instant case, we do not find any difficulty to hold that both the tests referred to above were satisfied by the assessee, in that, the assessee company has incurred expenses to earn profits in its business of marketing and it had incurred expenses not in its personal capacity as an agent to the products manufactured by its sister concerns, but in its capacity as a businessman in marketing the products by itself.

6.1. The above well settled legal position are being recapitulated by several decisions, as stated hereunder.

6.2. Justice.Shah, as he then was, speaking for the Full Bench of the Apex Court in Travancore Titanium Product Ltd. v. Commissioner of Income-tax [1966] 60 I.T.R. 277, held that to claim the expenditure incurred as a permissible deduction under Section 10(2)(xv) of the old Act, (now under Section 37(1) of the Act), there must be a direct and intimate connection between the expenditure and the business, i.e., between the expenditure and the character of the assessee as a trader, and not as owner of assets even if they are assets of the business. It is

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thus held that the nature of the expenditure or outgoing must be adjudged in the light of accepted commercial practice and trading principles and the expenditure must be incidental of the business and must be necessitated or justified by commercial expediency and that it must also be directly and intimately connected with the business and be laid out by the taxpayer in his character as a trader.

6.3. In applying the test of commercial expediency for determining whether the expenditure was wholly and exclusively laid out for the purpose of the business, reasonableness of the expenditure has to be adjudged from the point of view of the businessman and not of the revenue, vide Commissioner of Income-tax v. Walchand and Co. Private Ltd. [1967] 65 I.T.R. 381.

6.4. In Sassoon J.David and Co.P.Ltd. v. Commissioner of Income-tax, [1979] 118 I.T.R. 261, while interpreting the words "any expenditure laid out or expended wholly and exclusively for the purposes of the business or profession" to assail that the expression "wholly and exclusively" used in Section 10(2)(xv) of the old Act (now Section 37(1) of the Act), does not mean "necessarily", the Apex Court has held that ordinarily, it is for the assessee to decide whether any expenditure should be incurred in the course of his or its business and such expenditure may be incurred voluntarily and without any necessity and if it is incurred for promoting the business and to earn profits, the assessee can claim deduction under section 10(2)(xv) of the old Act, even though there was no compelling necessity to incur such expenditure. It was further held that the fact that somebody other than the assessee (like in the instant case, the sister concerns) is also benefitted by the expenditure should not come in the way of an expenditure being allowed by way of deduction under section 10(2)(xv) of the old Act (now Section 37(1) of the Act), if it satisfies otherwise the tests laid down by law, referred to above.

6.5. Recently, the Apex Court, in S.A.Builders Ltd. v. Commissioner of Income-tax (Appeals), [2007] 288 I.T.R. Page 1, interpreting the words "for the purpose of business" used in Section 37(1) of the Act, while computing the income chargeable under the head "Profits and gains of business or profession", reiterated its earlier views referred to above and held that such expenditure is to be tested in the light of the commercial expediency, which is one of wide import and includes such expenditure as a prudent businessman incurs for the purpose of business. The expenditure may not have been incurred under any legal obligation, but yet it is allowable as business expenditure if it was incurred on grounds of commercial expediency. It is further held that the expenditure incurred for the purpose of business meant in Section 37(1) of the Act includes the expenditure voluntarily incurred for commercial expediency and it is immaterial if a third party also benefits thereby. It is not for the authorities or the Court to examine the purpose for which the assessee incurred the expenses for its commercial expediency. What is relevant is whether the amount was advanced as a measure of commercial expediency and not from the point of view whether the amount was advanced for earning profits. Once it is established that there was nexus between

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the expenditure and the purpose of the business (which need not necessarily be the business of the assessee itself), the Revenue cannot justifiably claim to put itself in the arm-chair of the businessman or in the position of the Board of Directors and assume the role to decide how much is reasonable expenditure having regard to the circumstances of the case and no businessman can be compelled to maximize his profit.

For all these reasons, we do not see any question of law much less a substantial question of law that arises for consideration in this appeal. Accordingly, the tax case appeal is dismissed.

sra

Sd/-
Asst.Registrar

/true copy/

Sub Asst.Registrar

To:

1.The Assistant Registrar,
Income Tax Appellate Tribunal
Madras Bench "C",
Rajaji Bhavan, III Floor,
Besant Nagar, Chennai-90. (5 Copies)

2.The Commissioner of Income
Tax (Appeals)IV, Chennai.

3.The Deputy Commissioner of
Income Tax, Company Circle IV(4),
Chennai.

4. The Commissioner of Income Tax, Chennai.

+1 cc to Mrs.Pushya Sitaraman,
Senior Standing Counsel for IT Sr.No.32835.

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dcp/21.6.07

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